HOUSE FISCAL AGENCY

MEMORANDUM

DATE: April 12, 2005

TO: House Appropriations Subcommittee on Transportation

FROM: William E. Hamilton

RE: State Transportation Borrowing and Debt Service

This memo updates a memo dated March 8, 2005, presented to the subcommittee on March 23, 2005.

Authority for Transportation Bond Program

Article IX, Section 9 of Michigan's 1963 Constitution mandates that revenue from specific taxes on motor fuels and on vehicle registrations be used exclusively for transportation purposes. The section also states that, "*The legislature may authorize the incurrence of indebtedness and the issuance of obligations pledging the taxes allocated or authorized to be allocated under this section, which obligations shall not be construed to be evidence of state indebtedness under this constitution.*" This language gives constitutional authorization for debt secured by constitutionally-restricted transportation revenue, and indicates that transportation notes and bonds issued under the authority of this section are not general obligations of the state of Michigan.

Statutory authority for borrowing secured by constitutionally-restricted transportation revenue is found in Public Act 51 of 1951. Act 51 authorizes the State Transportation Commission to issue notes or bonds by pledging as payment constitutionally-restricted transportation revenue. Act 51 also authorizes the State Transportation Commission to issue notes or bonds in anticipation of federal revenue, and authorizes the refunding of previously issued bonds.

Section 18b of Act 51 requires that the State Transportation Commission, prior to issuing notes or bonds, adopt a resolution providing a pledge of payment of the notes or bonds from constitutionally-restricted transportation revenue. Section 18b also requires that the resolution contain a brief statement describing the projects for which the notes or bonds are to be issued, including estimated cost of the projects, or a description of the notes or bonds to be paid or refunded from the proceeds.

Section 18k of Act 51 requires that the State Transportation Commission provide to the House and Senate appropriations committees the list of projects for which notes or bonds are to be issued at least 30 days before the notes or bonds are issued. If the State Transportation Commission determines that the projects for which bonds were issued should change, Section 18b(4) requires that the Commission adopt the change by resolution, and that notice of intention to adopt the resolution be given to the House and Senate Appropriations Committees. Although Act 51 includes these notification provisions, the act does not require legislative authorization for the State Transportation Commission to issue notes or bonds, and does not give the appropriations committees or legislature as a whole authority to approve or reject the proposed project list.

Proceeds from the sales of notes or bonds can be used only for projects included in the note or bond resolution project list. However, the proceeds are not earmarked for any particular project or projects on the list. Some of the projects on the list may be constructed using other state-restricted or federal aid revenue sources. For example, the 125 projects shown in the list associated with the 2004 State Trunkline Fund bond issue represent the pool of projects for which the bond proceeds may be used.

State Transportation Commission authorization for note or bond sales is typically a two-step process. The Commission first authorizes the Michigan Department of Transportation to circulate a preliminary official note or bond statement, including the list of projects. In a subsequent resolution, after the 30-day notification period, the Commission will authorize the department to issue the notes or bonds up to the amount authorized in the resolution. The department will time the actual sale of the debt issue based on anticipated cash flow needs and on market conditions.

Debt Limits
Act 51 limits transportation-related debt service to 50% of the previous year's constitutionally-restricted transportation revenue. Or put another way, transportation revenue pledged to secure bonds or notes must be at least twice the amount of the related transportation debt service.[1] Current debt service is below these statutory limits. According to the state's September 30, 2004 Certified Annual Financial Report (CAFR), available revenues were 12.1 times the amount needed to cover State Trunkline Fund (STF) debt service, and 7.8 times the amount needed to cover Comprehensive Transportation Fund (CTF) debt service. Note that the STF debt service ratio does not include debt service on short-term federal grant anticipation notes described further below.

Issues in Transportation Bonding
Although current debt service is well within statutory limits, there is concern that increasing debt service obligations in the near future could have a significant impact on the department's ability to sustain its road and bridge program. Outstanding STF debt doubled between September 30, 2000 and September 30, 2001 – from $633.2 million to $1.328 billion. Of this increase, $308.2 million related to the sale in July 2001 of Build Michigan III bonds. At the same time, the department sold $400.0 million in short-term federal grant anticipation notes (GARVEEs). In September 2002, the department sold an additional $200.0 million in GARVEE notes. Repayment of GARVEE notes will have a significant impact on debt service starting in FY 2004-05.

The terms of the GARVEE notes required payment of only interest during the first three years of the notes. The first principal payment, of $24.0 million, is scheduled for FY 2004-05. GARVEE principal payments are scheduled to increase through FY 2008-09. In FY 2008-09 scheduled STF debt service would total approximately $296.8 million, including $208.0 million for GARVEE debt service. Estimated FY 2008-09 STF debt service represents approximately 25% of the department's current road and bridge construction program.[2] It should be noted that the department anticipates refinancing at least some of $600.0 million in outstanding GARVEE notes in order to extend and level out debt service.

The department has indicated that there are three primary reasons for the recent bonding program: Bonding allows the department to advance projects which would be more costly to build in the future due to construction price inflation. In addition, by advancing projects the economic benefits of improved transportation facilities are realized sooner. Finally, the recent transportation bond program has taken advantage of historically low interest rates.

Current and Anticipated Bond Program
In July 2004, the State Transportation Commission authorized the sale of up to $480.0 million in new STF bonds. The bond issue was to be used to advance various projects, primarily reconstruction, rehabilitation, and resurfacing projects. In August 2004, the department issued $185.7 million in bonds under this authorization. The department does not anticipate issuing additional bonds under this authorization in FY 2004-05, but may issue up to $280.0 million in FY 2005-06 depending on program needs, cash flow needs, and market conditions.

The department also anticipates asking the State Transportation Commission for authority to sell additional CTF bonds, including bonds for ASAP airport safety and security projects, depending on program needs, cash flow needs, and market conditions.

In addition to the previously authorized debt issue, the Governor has proposed $400.0 million in new transportation bonding as a component of the *Jobs Today* program. Details of this initiative have not been released at this time.

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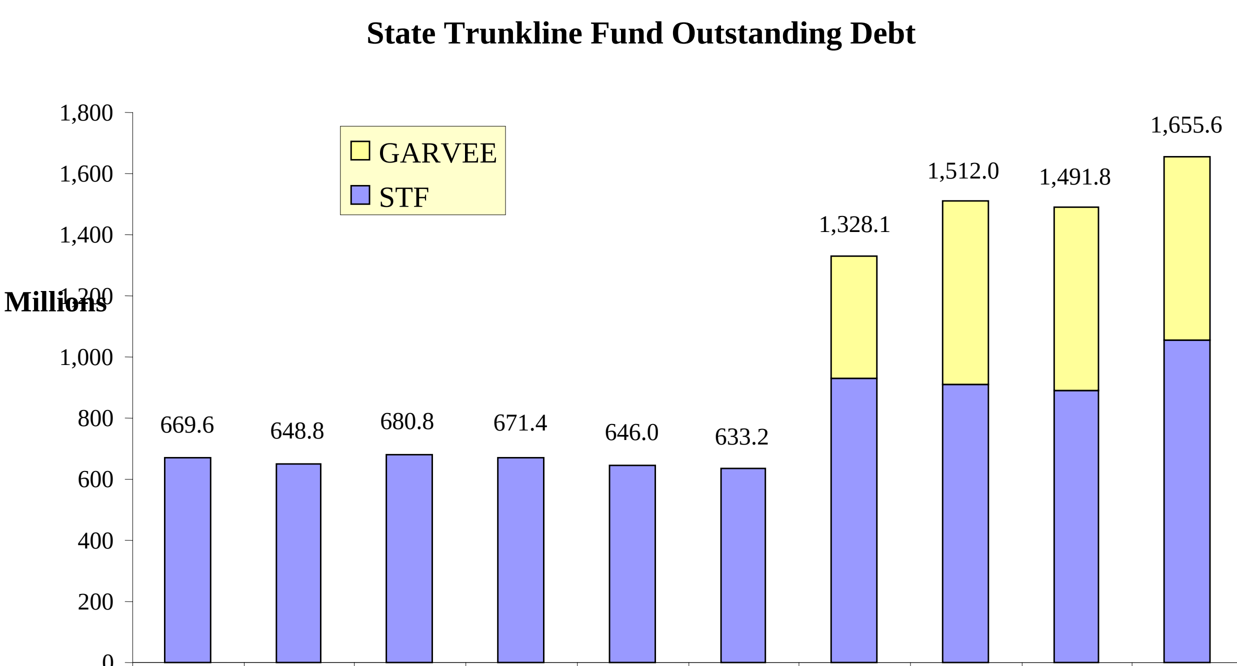
[1] In accordance with State Transportation Commission policy adopted August 26, 1999, the department adopted capital financing guidelines. Those guidelines require that restricted revenue must be at least four times annual debt service. The guidelines also require that bonding be used only for capital projects, infrastructure and equipment, and require the department to take every effort to ensure that the average life of bonds not exceed the average life of the capital financed projects.
[2] At the time the department issued the GARVEE notes, it anticipated that the state would receive additional federal aid through reauthorization of the federal aid program, the Transportation Equity Act for the 21st Century (TEA-21). TEA-21 expired on September 30, 2003 and has been extended several times on a short-term basis. However, Congress has not yet passed a long-term reauthorization.

Transportation Debt and Debt Service History

The tables and charts below and on the following pages show the history of state transportation debt and debt service from the 1994-95 fiscal year through FY 2005-06. The outstanding note and bond amounts are taken from the department's annual financial reports or from state CAFR. The debt service amounts through FY 2003-04 are based on actual debt service payments as recorded in the state's accounting system. Debt service amounts for FY 2004-05 and FY 2005-06 are the appropriated amounts based on the department's debt service schedules plus anticipated future borrowings.

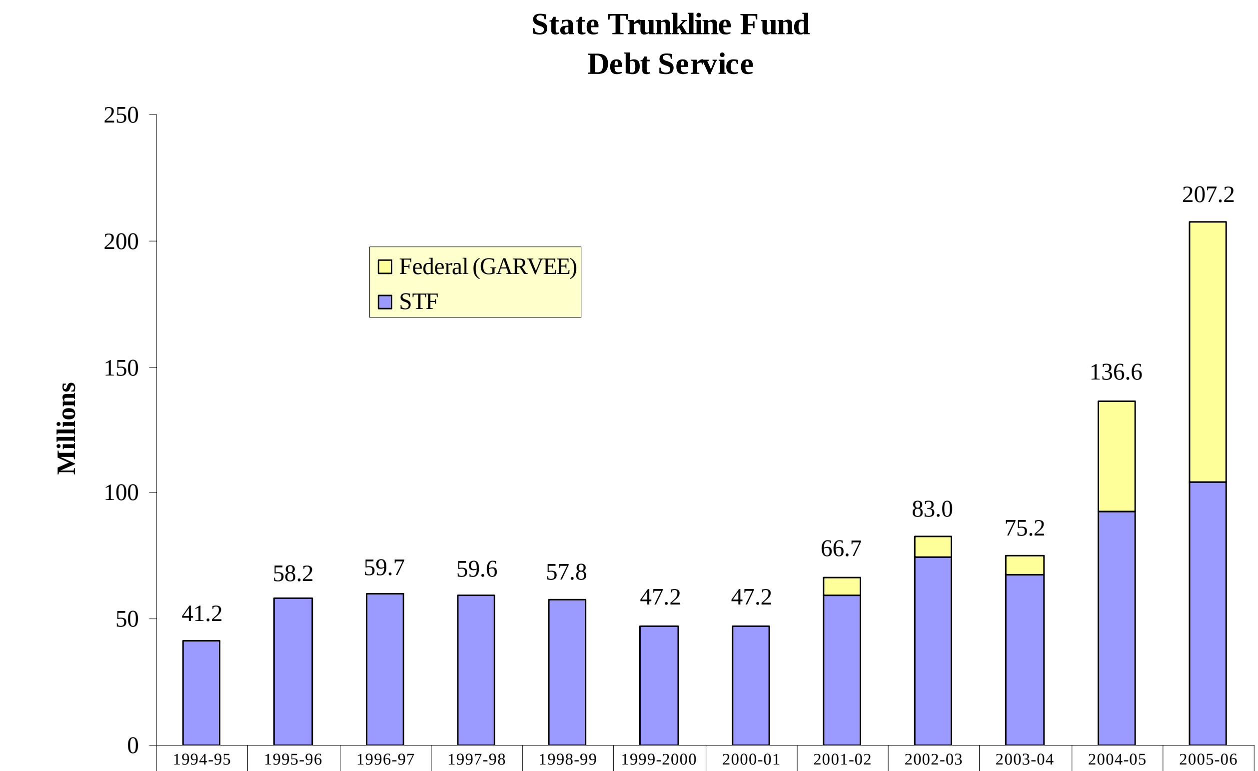
State Trunkline Fund

State Trunkline Fund bonds and notes are used to provide funds for state trunkline road and bridge construction or reconstruction projects. For purposes of the table and chart, STF bonds include bonds issued for Transportation Economic Development Fund (TEDF) projects, the Blue Water Bridge (second span), and Critical Bridge Program projects – as well as state trunkline construction projects. The TEDF, Blue Water Bridge, and Critical Bridge Program bonds are considered "STF" because they are secured by STF revenue. The tables and charts also include GARVEE notes.



	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000	2000-01	2001-02	2002-03	2003-04
GARVEE							400,000,000	600,000,000	600,000,000	600,000,000
STF	669,583,000	648,798,000	680,778,000	671,432,000	645,990,000	633,219,000	928,052,000	911,967,000	891,770,000	1,055,645,000

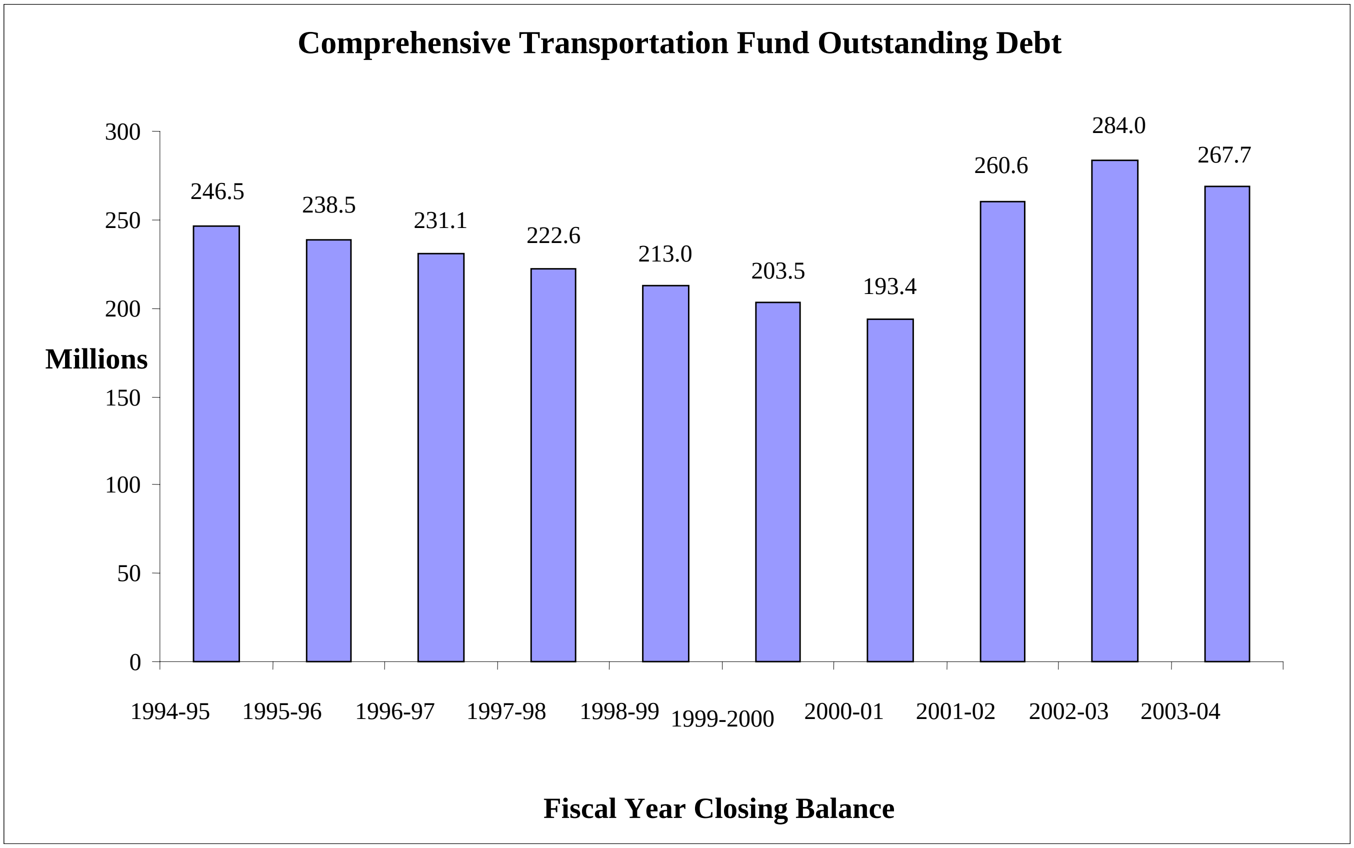
Fiscal Year Closing Balance

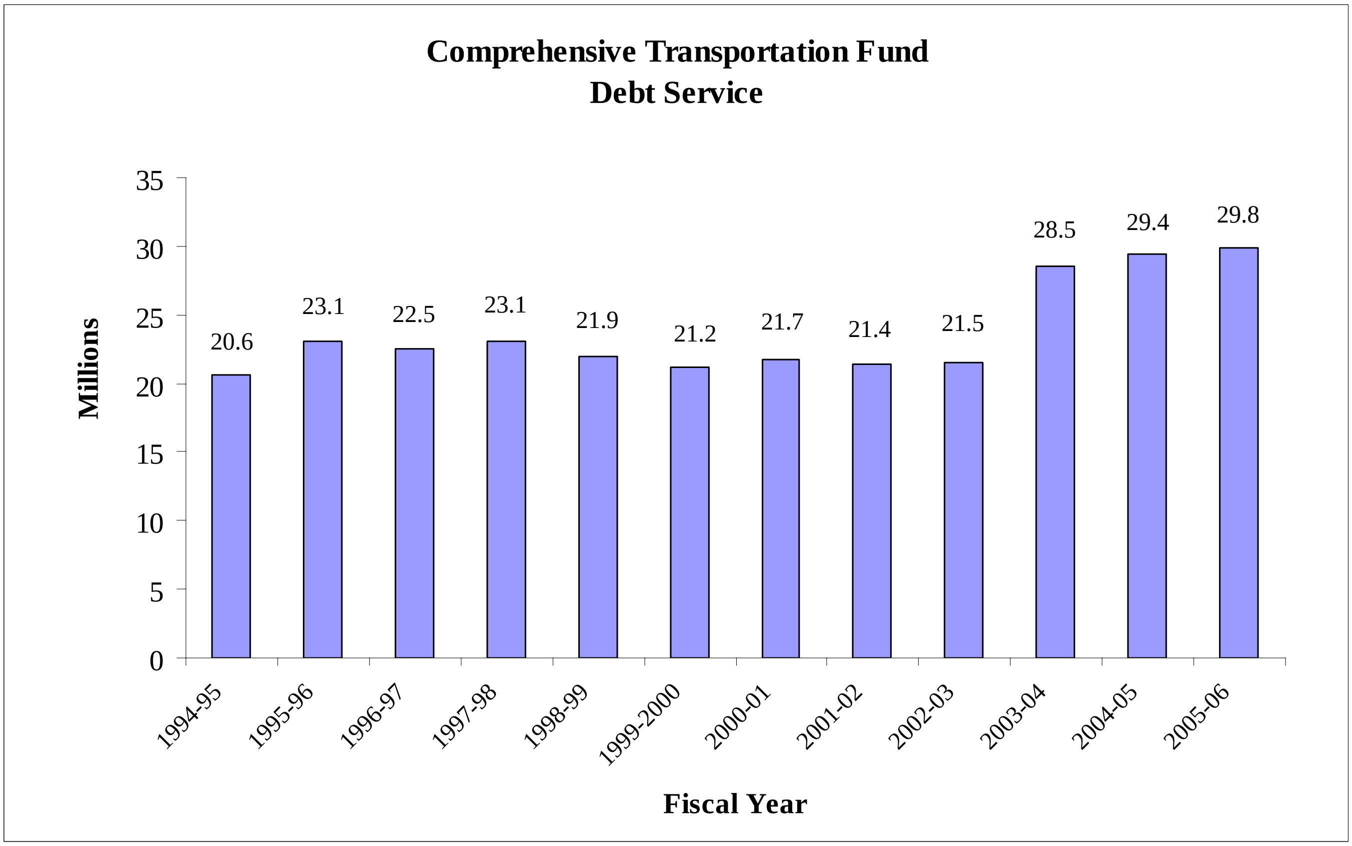


	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
Federal (GARVEE)								7,331,174	8,188,877	7,373,848	44,000,000	103,200,000
STF	41,208,728	58,185,515	59,737,132	59,577,357	57,750,999	47,209,099	47,200,259	59,361,635	74,774,663	67,811,662	92,583,500	104,030,600

Comprehensive Transportation Fund

Comprehensive Transportation Fund bonds are used to fund public transportation capital projects, including the purchase of buses for transit agencies, construction of bus transit bus intermodal terminals, and rail freight construction projects. CTF bond proceeds have also been used to support certain airport improvement projects.




Comprehensive Transportation Fund
Debt Service
Millions
35
30
25
20
15
10
5
0
20.6
23.1
22.5
23.1
21.9
21.2
21.7
21.4
21.5
28.5
29.4
29.8
1994-95
1995-96
1996-97
1997-98
1998-99
1999-2000
2000-01
2001-02
2002-03
2003-04
2004-05
2005-06
Fiscal Year

Transportation Bond Program
Summary of Recent Bond Issues

1989 -$135,779,506 in STF Bonds
Used primarily to finance a number of state and local economic development (TEDF) projects. Approximately 38% of the funds were used for state trunkline projects - 59% if one includes projects which involved the upgrading of local roads and jurisdictional transfers to the state. Included among the listed projects were the Haggerty Road extension in Oakland County, Davison Freeway reconstruction in Detroit, and upgrading the Capital Loop in Lansing.

The original 1989 bond statement shows $100 million for TEDF projects. The January 18, 1996 reprogramming letter shows $120.5 million in TEDF projects.

In addition to the funds used for TEDF projects, approximately $30 million from the original bond proceeds were used for state trunkline right-of-way projects.

1992 - $253,618,067 in STF Bonds for "Build Michigan I"
Primarily used to match federal funds for state trunkline projects. In addition, approximately $30.0 million of the bond proceeds were used for local Critical Bridge projects. At the same time, the department issued $37.7 million in CTF obligation bonds.

Note that the total Build Michigan I bond issue was $353.2 million, of which $253.6 million was "new money". The balance of the bond proceeds were used to refund existing debt.

1994 - $150,000,000 in STF Bonds
Used entirely for state trunkline projects.

1996 - $55,000,000 in STF Bonds
$35.0 million was used to finance, in part, Blue Water Bridge construction (second span) and $20.0 million was used for advance purchase of right of way.[3]

1998 – In 1998 the department issued $377.9 million STF, and $38.6 million CTF refunding bonds.

2001 - $308,200,000 in STF Bonds for "Build Michigan III"
These bonds, issued in July 2001, were intended to be the first phase of the Build Michigan III bond program. The proceeds were used to finance a number of state highway reconstruction, capacity improvement, and local economic development projects. The department originally anticipated issuing additional Build Michigan III bonds; the State Transportation Commission had authorized up to $900.0 million in borrowing under the Build Michigan III program. However, no additional bonds were issued under this program.[4]

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[3] Under this program, the department purchased right of way in advance of the completion of early preliminary engineering and environmental clearance. The department subsequently discontinued the use of the advance purchase of right of way account. Use of advance purchase of right of way makes the entire project ineligible for federal aid. Cost savings achieved in purchasing right of way prior to final highway alignment are offset by the loss of federal project participation.

[4] Debt service for the Build Michigan III bond program was to have come, in part, from an annual $35 million appropriation from the Budget Stabilization Fund (BSF) for a sixteen-year period beginning in FY 2000-01 and ending in FY 2015-16. The $35 million BSF transfer was made for the first two fiscal years, but was suspended in FY 2002-03 because of reduction in GF/GP revenue and the depletion of the BSF. In addition, $8.0 million per year was to have come from a proposed increase in the diesel motor fuel taxes. The proposed diesel tax increase was not enacted.

2001 - $400,000,000 in GARVEE Notes
These notes, issued in July 2001, were issued to accelerate previously programmed state trunkline projects ("Build Michigan II"). These are considered short term notes (less than 10 year maturity). The state pledged anticipated revenue from the federal aid highway program to secure repayment of these notes. This was the first series of bonds issued under this program.

In July 2001, at the same time the department issued the Build Michigan III bonds and GARVEE notes, it refinanced $27.8 million in CTF bonds.

2002 - $82,310,000 in CTF Bonds
On July 19, 2002 the State Transportation Commission authorized the sale of up to $160.0 million in CTF bonds by December 31, 2002. Bonds were issued in August 15, 2002 for a number of public transit capital projects, including rail freight track rehabilitation projects, local public transportation bus and facility projects, intermodal terminal projects, and rail passenger projects. The State Transportation Commission approved bond project list identifies $88.5 million in various CTF projects, plus $60.0 million for various ASAP airport safety and security projects.[5] However, none of the proceeds were used for ASAP projects, and no additional CTF bonds were issued under this authorization. As described further below, the department issued bonds fro the ASAP program in 2003 under a separate authorization from the State Transportation Commission.

2002 - $200,000,000 in GARVEE Notes
On September 19, 2002 the department issued an additional $200.0 million in short-term federal-aid grant anticipation notes intended to accelerate previously programmed state trunkline projects ("Build Michigan II"). This was the second series of bonds issued under this program bringing total GARVEE borrowing to $600.0 million.

In May 2002, the department sold $89.6 million to refinance CTF debt. The total proceeds (including premium) refinanced $95.6 million in CTF bonds. In August 2002, the department sold $97.9 million in STF refunding bonds. The total proceeds (including premium) totaled $104.5 million.

2003 - $35,020,000 in CTF Bonds
The State Transportation Commission authorized the sale of up to $38.0 million in CTF bonds on April 24, 2003. Bonds were issued June 25, 2003. The approved bond list was identical to the one approved in 2002 – $88.5 million in various CTF bond projects and $60.0 million for ASAP airport improvement projects. The department identified $24.0 million from the bond proceeds as related to the ASAP program. The department anticipates selling up to $36.0 million more in CTF bonds for the ASAP program to reach the $60.0 million estimated program requirement.

In April 2003, the State Transportation Commission authorized the reprogramming of bond proceeds and revised the project lists for 1992 CTF issue, and the 2002 CTF issue.

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[5] ASAP represents the "Airport Safety and Protection Plan," a bond program funding airport safety and security projects. The bond project list identified $60.0 million in ASAP bond program funds, although total ASAP project costs, including federal, local, and other state revenue, total approximately $1.1 billion.

Although ASAP debt service is shown as State Aeronautics Fund (SAF) in the transportation appropriations acts, the bonds are guaranteed with CTF revenue; the State Transportation Commission has no constitutional or statutory authority to issue bonds secured with SAF revenue. The CTF will make the debt service payments and the SAF will reimburse the CTF. The appropriated amount for ASAP debt service was $1.8 million (SAF) in both FY 2003-04 and FY 2004-05. The SAF revenue for the debt service reimbursement was guaranteed through an earmark of certain Airport Parking Tax revenue made in Public Act 680 of 2002 (HB 4454).

2004 - $185,710,000 in STF Bonds
On July 29, 2004, the State Transportation Commission authorized the issuance of up to $480.0 million in STF bonds. The bond list identified a total of 125 projects with a total estimated cost of $633.6 million. The projects were primarily reconstruction, rehabilitation, or resurfacing projects (*Preserve First*). There were 3 capacity improvement projects on the list: M-24 in Lapeer County, I-96 at 36th Street in Kent County, and M-42 in Wexford County.

On August 18, 2004 the department issued $185.7 million in bonds, ($201.2 million including premium to issue date) as part of that authorized bond sale. The department anticipates selling an additional $280.0 million under this authorization in 2005.

In April 2004, the department sold $103.5 million in STF refunding bonds. The total proceeds (including premium) totaled $113.2 million.